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SUBJECT: CENTRAL BANK OUTLOOK POSITIVE

REF: LA PAZ 1791

¶1. (SBU) Summary: According to a Central Bank official, Bolivia's macroeconomic situation is positive overall, with first semester GDP growth of 4.3 percent, strong fiscal revenue inflows, low deficit projections, moderate inflation, high international reserves, and a sound banking system. However, uncertainty in the hydrocarbons sector could dampen future growth, while a mismatch in central and regional government income and spending responsibilities could reduce the effectiveness of public expenditure. End summary.

Strong GDP Growth, Low Deficit Projection

¶2. (SBU) Central Bank Economic Policy Advisor Armando Pinell told Econoff on August 2 that the Bolivian economy was performing well overall, despite uncertainty in the hydrocarbons sector due to the GOB's nationalization policy. Gross domestic product (GDP) grew by 4.3 percent in the first half of 2006 and strong revenue inflows (2.5 billion bolivianos or USD 312 million during first semester 2006) from hydrocarbons taxes, other business taxes, and customs have produced a fiscal surplus. Pinell predicts a combined public sector deficit at near zero for 2006, compared to 3 percent of GDP projected in the budget, because the government will not immediately spend higher than anticipated hydrocarbons revenue. The Central Bank will publish a new monetary policy paper around the end of September, Pinell said.

Central Government Financing Gap

¶3. (SBU) Despite overall near zero deficit projections, the central government will likely face a serious shortfall in available funds by year-end if regional income is not transferred to central government accounts, Pinell said. Currently, regional governments have large surpluses that they are not investing, because significant income is transferred to them by the central government, while major fiscal responsibilities are not. Pinell suggested that the contentious issue of revenue sharing, particularly of

hydrocarbons taxes, would be discussed at the Constituent Assembly.

Inflation Concerns and Revaluation

¶4. (SBU) Although the Central Bank aims to control inflation, which is currently around 4.5 percent and is projected to be the same at year-end, it is unlikely to significantly revalue the boliviano to do so. A slight revaluation is probable, but Pinell said that the Bank would not implement a large increase in local currency value, because it must consider the impact on exporters and local producers who benefit from a cheap boliviano. Pinell explained that because of strong appreciation of the Brazilian real last year, Bolivia is importing inflation from its neighbor. Although increasing prices cause concern, local producers benefit because their cheaper goods are now more competitive vis-a-vis Brazilian imports.

Bolivianization Increasing, Reserves High

¶5. (SBU) Central Bank policies of encouraging local currency use instead of dollars have been fairly successful in increasing boliviano use, with approximately 20 percent of deposits and 10 percent of loans now held in local currency. Partially due to large export earnings and partially because of the public shift away from dollar use, the Central Bank has record high international reserves (USD 2.67 billion).

Banking System Stable, Exchange Controls Unlikely

¶6. (SBU) Pinell said that the financial system is sound overall. Although bank deposits decreased slightly during the first half of the year, he explained that deposits actually increased in every month except May. He attributed the dip in May to false rumors of GOB-imposed exchange and deposit withdrawal controls. Loan portfolios increased during the first semester. Pinell explained that the idea of implementing currency exchange controls was "in fashion when the Venezuelans were here", but fortunately has fallen by the wayside. He did not think the GOB would seek to implement such controls in the foreseeable future.

¶7. (SBU) Comment: Although Bolivia's short-term macroeconomic outlook is positive, several risk factors could impede mid and long-term growth (reftel). Private investment is likely to remain low due to the GOB's policies of increasing state control in the hydrocarbons and other key sectors. Export revenues have already begun to decrease in anticipation of Bolivia's likely loss of U.S. trade preferences in December. Although the Central Bank has thus far continued the monetary policies of the previous administration, the Bank's new directors seem amenable to changing the Bank's prior conservative policies in order to support GOB goals, such as employment generation, possibly to the detriment of macroeconomic stability. End comment.
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